Sanborn Yearwood & Associates

Davidsonville, MD ***May 4, 2004***

Docket Management Facility
USCG-2003-14472 or Marad Docket No. MARAD-2003-15171
Department of Transportation – Room PL-401
400 Seventh Street SW
Washington, DC 20590-0001

Re: USCG-2003-14472 or Marad Docket No. MARAD-2003-15171
Joint Notice of Proposed Rulemaking
Lease Financing for Vessels Engaged in the Coastwise Trade

Gentlemen:

We are pleased to offer our comments regarding the subject joint notice of proposed rulemaking.

Sanborn Yearwood & Associates (SYA) is an organization providing management consulting services to commercial and financial clients in the international and domestic maritime industries. Its principals have advised and arranged financing of foreign and U.S. maritime assets, including Jones Act vessels; managed U.S. and foreign vessels; chartered such vessels in and out and represented foreign financing sources in the United States. SYA has advised foreign clients on financing marine assets in the U.S. and U.S. based clients on foreign financing alternatives.

It appears clear that many of the issues raised in the proposed rulemaking are done so to satisfy those owners operating in the domestic trade and concerned with competition regardless of the legislation designed to encourage foreign lease financing. These owners apparently believe any change affecting the Jones Act, even if such change is potentially beneficial to them by providing additional financing sources or business exit strategies, must be opposed in a Pavlovian protectionist reaction.

<u>Chartering Back</u>
The proposed restrictions or prohibitions on chartering back are said to be put forth in an effort to lessen foreign control of a ship that arises in some manner, undefined in the proposed regulation, only when the owner and charterer are related. There seems to be no issue of control by the owner that is specifically addressed in the under-lying legislation and therefore the "unintended" control must arise from the addition of the charterer where that charterer is related to the owner.

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Control of ships is effected by:

- *a manager, when that manager issues orders to a ship;*
- *the Master and crew, when executing these orders and using their decision-making authority to do so; and*
- *the government, under whose legal regime the ship resides.*

These factors have nothing to do with the nationality of a time, voyage or space charterer. We believe there are only two circumstances where an additional element of foreign control can possibly arise. The first is the case where the owner and manager are one and the same and the foreign owner is in the position of being able to issue orders to a ship. This possibility is precluded by legislation requiring a U.S. citizen manager. The second case arises when the time charterer is given authority by the manager to issue cargo orders (type, quantity, load and discharge ports/berths) directly to the ship rather than have those orders come through the U.S. citizen manager. If the issuance of cargo orders is deemed to be unacceptable control, it would seem the effective and simple solution is to prohibit the time charterer from giving, and the ship from accepting, cargo orders directly from the time charterer. We "believe that this is a more effective way to ensure that control of the vessel is not returned to the owner's group through a charter-back arrangement".

To demonstrate the absurdity of the restriction as proposed, we pose some additional questions presuming that the issue of undue control is so acute as to warrant prohibiting a relationship between owner and charterer:

- *Shall a harbor assist tug be prohibited from rendering contract ship assist services to a vessel when the charterer of the vessel and the beneficial foreign owner of the tug through lease financing mechanisms are the same?*
- *Shall a container vessel be prohibited from transporting one or more containers where the cargo and the containership have a common beneficial foreign owner?*
- *In the case of cruise vessels; shall an officer or other employee of a foreign lease financing institution be prohibited from cruising on the vessel as a paying passenger?*

We note that the proposed regulations do not address the issue of control when two different beneficial entities are involved, that is, a foreign beneficial owner and a different foreign time charterer. If foreign control is the issue to be addressed, rather than some distorted view of competition, should the matter of two different foreign entities be addressed?

<u>Cargo Ownership Exclusion</u>

The proposal to permit chartering back when the vessel - "is engaged in carrying cargo owned by the vessel's owner or by a member of the group which the vessel's owner is a member" is puzzling. On the one hand it is stated that charter back regulations are being promulgated to minimize the possibility of excessive foreign control, yet it is proposed to allow common foreign ownership of a vessel and common foreign chartering of the vessel when there is also common foreign ownership of the cargo. This seems absolutely illogical in that it clearly must result in greater foreign control. It allows three degrees of foreign control (ship, charter and cargo) while prohibiting or restricting

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two degrees (ship and charter). Also, from a commercial standpoint, granting such an exception will put the vessel, and the entire transaction, at a commercial disadvantage in the marketplace for the vessel apparently will be unable to transport cargoes not owned by the owner/time charterer of the vessel. In many trades such third party cargoes are used to fill out vessels or replace owners' cargoes after periods of overliftings or shortages. Thus, according to the proposed exception, a U.S. flag vessel, managed by a U.S. company, qualified for the domestic trade will be unable to transport cargoes owned by other U.S. companies.

Perhaps to overcome the foregoing, which must be an unintended consequence of this rule making for it results in an absurd scenario, the time charterer could purchase the cargo and then resell the cargo at the discharge port…provided, of course, that this would not be deemed a sham transaction.

It seems quite clear that there is no justification for an exception in the case of foreign ownership of the cargo.

It also seems clear that the thought of a prohibition against chartering back is designed to frustrate the issue of foreign lease financing and serves no practical purpose.

As indicated above, the proposed restriction or prohibition on chartering back represents an effort to lessen the chance of foreign control. However, it only addresses the issue of chartering back that is, chartering to an entity under common control. Presumably where a vessel has been documented pursuant to 46 U.S.C. 12016 (e), it can be time chartered by a demise charterer to a foreign entity if that foreign entity is not a member of the "owner's group". This seems puzzling for it results in the same three degrees of foreign control, albeit by two different entities.

<u>Grandfathering</u>

A three-year period for grandfathering appears to be a further effort to discourage the very competition that the legislation was designed to foster.

Financing institutions, owners, charterers, etc., all entered into presently existing transactions under then existing rules in good faith. Many of these transactions involved long life marine assets. To have a transaction's life artificially shortened by a change in rules can only have the effect of discouraging those who have entered into transactions from further considering the same in the future. Early termination of an investment can have many adverse and significant consequences, such as:

- *The financing institution may incur costs associated with untimely disposition of an asset, recapture of tax benefits, etc.*
- *The operator may be faced with early contract termination costs and face the task of laying off personnel, cutting other costs relating to the quality of his operation, etc.*
- *Labor unions may be faced with the need to find employment for personnel laid-off.*
- *Charterers, who thought they had a long-term transaction, will be faced with all of the costs associated with finding alternative capacity.*

Permitting a long-term transaction to be entered into and then changing the rules mid-stream can only have adverse transactional consequences and serve as a warning to those contemplating the use of such financing in the future. While Congress intended to

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broaden the sources of capital for owners of U.S. vessels in the coastwise trade, the regulators are apparently considering narrowing the sources of capital.

The fact that Congress specified a three-year period as the minimum duration of a "long term" demise charter is being taken as the maximum period by the proposed regulation. Since marine assets are long-life assets, restriction to a three-year period of certainty will eliminate the interest of foreign financing institutions.

Equity would argue for leaving any completed or approved transaction in place and when future approvals are granted, they should be granted for the life of the transaction. Any lesser period will discourage long-term financing.

<u>Approval by a Third Party</u>

While it is clear the agencies do not have the expertise in vessel chartering that may be necessary to review and approve applications for an endorsement under lease-financing provisions, we do not believe use of an independent third party to be a solution to this problem for the following reasons:

- *In the absence of criteria to be met for an application, an independent third party cannot be expected to be in a position to utilize expertise to perform consistent evaluations. Furthermore, potential applicants deserve criteria against which they can structure and measure their own conformance, prior to commencing the regulatory process.*
- *Vessel charters, their terms and conditions, rates, options, penalties, etc., all involve commercially confidential matters which charterers are reluctant to share with third parties, particularly third parties with expertise in the vessel chartering.*
- *An adverse decision or recommendation by a third-party evaluator has a high probability of leading to a lawsuit against two parties, the evaluator and the government. This will result in additional costs and time when compared with a single defendant.*
- *Finally, we believe that the agencies involved in this rule making should not delegate their authority to regulate business to independent third parties or private industry. This activity most properly resides with the government.*

In our view the questions raised in the notice paragraphs 3.-(a) through (h) clearly indicate the unworkableness of using a third-party evaluator.

<u>Maritime Administration (Marad) Approval of Time Charters</u>

We do not believe that Marad should be involved in approval of time charters. Marad has, at best, limited expertise in the area of chartering. Furthermore, any approval process will take a period of time which may not be available to a charterer interested in concluding a piece of business. For example, a voyage charter might be concluded, without documentation, in a period of less than one hour for prompt lifting, say within hours to a few days. Clearly, Marad will not be in a position to review such a charter, particularly when documentation of the transaction may not be concluded until the cargo has been loaded and discharged.

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Additional Issues

As presently structured, we believe the rulemaking will have some additional, perhaps unintended consequences, which will serve to discourage foreign entities from entertaining the very type of financing we believe Congress intended to allow. For example:

- U.S. financing institutions may acquire and lease maritime assets (e.g. barges) to a wide variety of end users. After doing so they may wish to sell the leased assets for commercial reasons. Certainly, any foreign buyer, faced with the uncertainty of the subject rulemaking and the expense and difficulty of evaluating its relationship with the time or voyage charterer for each asset over time, will not be in a position to proceed with a purchase.

- The uncertainty associated with the rulemaking coupled with the intended date of effectiveness of February 4, 2004 sends a tempering message to those contemplating foreign lease financing. Investments of the magnitude required for maritime assets cannot be made under the cloud of an uncertain regulatory change. It is only logical to make any change effective on final notification of that change (i.e. publication) at the earliest.

In summary, we suggest the following:

- The thought of requiring transactions to be "approved" be abandoned.

- If transactions must be "approved", once so approved, the approval should be valid for the life of the underlying financing associated with the transaction's assets.

- Grandfathering of existing transactions entered into in good faith by a number of commercial organizations should be for a like period.

- No restrictions should be placed on the end user of a vessel's cargo carrying capacity.

- Third party approval of transactions should not be permitted.

- Considering the lack of necessary specificity in this proposed rulemaking, the absence of standards against which to measure compliance, the fact that provisions are contrary to legislation and the discouraging impact it will have on those interested in financing marine assets, we suggest that a revised notice be published after these fatal defects are remedied.

We believe that the proposed rulemaking is so seriously flawed that, if adopted, it will operate to not only discourage, but also effectively to prohibit, vessel lease financing by foreign entities, thereby frustrating the underlying law and the intent of Congress.

Sincerely,

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